

***United States Court of Appeals
for the Second Circuit***



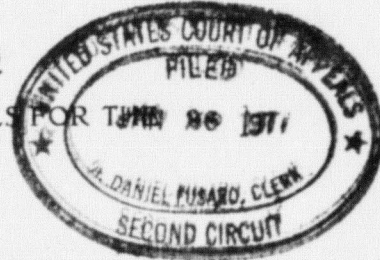
**APPELLANT'S
BRIEF**

77-6010

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BRIEF FOR APPELLANTS

UNITED STATES COURT OF APPEALS FOR THE
SECOND CIRCUIT



No. 77-6010

NATIONAL ASSOCIATION OF COMMODITY OPTION DEALERS, a non-profit association, BRISTOL OPTIONS INC., CHARTERED SYSTEMS CORPORATION, BRITISH AMERICAN COMMODITY OPTIONS CORPORATION, CLEARY TRADING COMPANY, INC., FIRST NEW YORK COMMODITY OPTIONS, INC. OF LOS ANGELES, WILLISTON CORPORATION, LLOYD, CARR AND COMPANY and INTERNATIONAL COMMODITY OPTIONS, LTD.,
PLAINTIFFS-APPELLANTS

v.

THE COMMODITY FUTURES TRADING COMMISSION, WILLIAM T. BAGLEY, Chairman COMMODITY FUTURES TRADING COMMISSION, JOHN B. RAINBOLT, II, Vice Chairman COMMODITY FUTURES TRADING COMMISSION, GARY SEEVERS, Commissioner COMMODITY FUTURES TRADING COMMISSION, READ P. DUNN, JR., Commissioner COMMODITY FUTURES TRADING COMMISSION and ROBERT L. MARTIN, Commissioner COMMODITY FUTURES TRADING COMMISSION,
DEFENDANT-APPELLEES

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

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Attorney for Appellants

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ISSUES PRESENTED

- I. Did the District Court err by granting the Appellees summary judgment as to the procedural validity of the regulations when a genuine dispute existed as to a material fact?
- II. Did the District Court err by granting the Appellees summary judgment as a matter of law as to the procedural validity of the regulations when the Commodity Futures Trading Commission failed to provide public hearings as required in 7 U. S. C. §6c(b) (Supp. V, 1975)?
- III. Did the District Court err by granting Appellee's Motion for Summary Judgment as to the substantive validity of the regulations when questions of fact exist as to the reasonableness of each regulation?

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PLAINTIFFS-APPELLANTS

V.

THE COMMODITY FUTURES TRADING COMMISSION, WILLIAM T. BAGLEY,
Chairman COMMODITY FUTURES TRADING COMMISSION, JOHN B. RAINBOLT, II,
Vice Chairman COMMODITY FUTURES TRADING COMMISSION, GARY SEEVERS,
Commissioner COMMODITY FUTURES TRADING COMMISSION, READ P. DUNN,
JR., Commissioner COMMODITY FUTURES TRADING COMMISSION and ROBERT
L. MARTIN, Commissioner COMMODITY FUTURES TRADING COMMISSION,

DEFENDANT-APPELLEES

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

STATEMENT OF THE CASE

A. INTRODUCTION

Citations herein are to the documents in the record by document page and not record page. Due to the expedited nature of this appeal, appellants were unable to cite to parts of the record reproduced in the joint appendix. The Appellants apologize for any inconvenience caused thereby.

B. NATURE OF THE CASE

Plaintiff sought in the District Court pre-enforcement judicial review of regulations relating to commodity options transactions, which were proposed on November 22, 1976, by the Commodity Futures Trading Commission, a federal agency, which administers the Commodity Exchange Act, as amended, 7 U.S.C., Sections 1-22 (Supp. V, 1975). The challenged regulations - 17 C.F.R., Sections 1.3, 1.17, 32.1-32.10, 41 Fed. Reg. 51808, 51814-51817 (November 24, 1976), generally set forth the terms and conditions under which transactions and commodity options will be permitted, by imposing registration, financial, segregation, disclosure, recordkeeping and anti-fraud requirements upon persons who wish to engage in the business of offering and selling commodity options to the public after the effective date of these regulatory provisions. The effective date of the regulations was December 9, 1976, though registration regulations did not require registration with the Commission until January 17, 1977.

The plaintiffs are seeking a declaratory judgment as the regulations were promulgated without compliance with the rulemaking procedures of the Administrative Procedure Act and are otherwise violative of certain provisions of the United States Constitution. The plaintiffs, British American Commodity Options Corporation and LLoyd, Carr & Co. originally brought their action in the United States District Court for the Southern District of New York. The plaintiffs, National Association of Commodity Option Dealers, and others, brought a similar action in the United States District Court for the District of Columbia, which action was

subsequently consolidated with the other pending case in the United States District Court for the Southern District of New York. Both actions sought a preliminary and permanent injunction against the defendants, preventing them from implementing and enforcing the regulations.

The grounds for relief asserted in the complaints are basically that (1) the promulgation of these regulations by the defendants was arbitrary, capricious and an abuse of discretion and unwarranted by the facts since the regulations imposed are unduly burdensome obligations which bear no relationship to the business operations of the plaintiffs and other vendors of commodity options, and are wholly unnecessary to the proper protection of customers or to any other regulatory objective; (2) in adopting the regulations the Commission acted in excess of its statutory authority under Section 4c(b) of the Act, 7 U.S.C., Section 6c(b) (Supp. V, 1975), and also violated the requirement of Section 15 of the Act, 7 U.S.C., Section 19 (Supp. V., 1975); that it endeavor to utilize the least anti-competitive means to effectuate the statutory purpose when it imposed anti-competitive requirements which discriminated against the plaintiffs; (3) the regulations were adopted without observance of procedural requirements in the Administrative Procedure Act, 5 U.S.C., Section 553(d)(1970). The Commission did not state any "good cause" for permitting the regulations to become effective less than thirty (30) days after publication; and (4) the regulations deprived the plaintiffs of their property without constitutional due process and deprived the plaintiffs of their right of privacy by imposing requirements which would put the plaintiffs out of business and will require them to reveal every aspect of their business to a public agency and by failing to set forth standards for granting or denying exemptions from the regulatory requirement.

C. DISPOSITION IN THE COURT BELOW

In response to the plaintiffs' Motion for Preliminary Injunction, the Commission moved for Summary Judgment. After full hearing, the District Court

(Hon. Whitman Knapp, J.) granted the plaintiffs Motion for Preliminary Injunction as to the regulations pertaining to segregation (32.6), denied the temporary restraining order as to the other regulations and granted the defendants' Motion for Summary Judgment as to each contested regulation, except for segregation.

The plaintiffs noted their appeal and petitioned the District Court for a stay of the enforcement of the regulations pending appeal. When that was denied plaintiffs appeared before this Honorable Court seeking a stay pending appeal and that relief was denied and the plaintiffs were granted an expedited appeal.

D. STATEMENT OF THE FACTS

On October 23, 1974, Congress enacted the Commodity Futures Trading Commission Act of 1974, 88 Stat. 1389. That legislation extensively amended the Commodity Exchange Act, 7 U.S.C. Section 1-17b (1970), and created the Commission as an independent Federal regulatory agency, which since April 21, 1975, has been responsible for administering and enforcing the provision of the Act, as amended. Prior to the 1974 amendments, the Act had been administered by the Commodity Exchange Authority of the Department of Agriculture, and applied only to trading in certain specifically-enumerated agricultural commodities. The 1974 amendments expanded the coverage of the Act to encompass virtually all previously unregulated commodities.

Those amendments also expanded the regulatory authority of the Commission as compared to its predecessor and gave the Commission "exclusive jurisdiction" to regulate accounts and agreements known to the trade as options.

The main area of Commission responsibility relates to contracts of sale of commodities for future delivery traded or executed on boards of trade, i.e., commodity exchanges, that have been designated by the Commission as "contract markets" for specific commodity futures contracts.

It is unlawful to effect a commodity futures transaction otherwise than by or through a member of a board of trade that has been designated as a contract market by the Commission. In order for a board of trade to obtain designation as a contract market for a particular commodity futures contract, it must meet various requirements; and must continue, after designation, to maintain specific standards including enforcement of its rules, preventing manipulation and cornering of the market and maintaining a clearing system to secure the financial integrity of futures contracts by guaranteeing performance of trades made in such contracts. In addition, futures commission merchants and other professional participants in the markets must register with the Commission and comply with anti-fraud, reporting and recordkeeping provisions. Futures commission merchants are also subject to a Ten Thousand Dollar (\$10,000.00) minimum capital requirements and must segregate customer funds.

The Commodity Exchange Authority, the predecessor to the Commission, did not have jurisdiction over options on any commodities other than those specifically enumerated in Section 2(a)(1) of the Commodity Exchange Act; as to those enumerated commodities, option trading was prohibited and continues to be prohibited. See Section 4c(a) of the Act, 7 U.S.C. Section 6c(a) (Supp. V, 1975). Prior to the enactment of the commodity option provisions that are now contained in Section 4c(b) of the Act, 7 U.S.C. Section 6c(b), however, neither the Commodity Exchange Authority nor any other governmental agency had the power to regulate options on other commodities.

In response to testimony in hearings on the 1974 amendments that commodity option transactions serve an economic purpose, Congress vested the Commission with authority over options relating to all commodities which would newly become subject to the Act by reason of the 1974 amendments, mandating that the Commission determine whether option transactions should be permitted and, if so, under what circumstances. This statutory authority is set forth in Section 4c(b) of the Act, 7 U.S.C. §6c(b) (Supp. V, 1975).

On April 25, 1975, just four days after it came into existence, the Commission proposed an anti-fraud rule relating to commodity options and solicited written public comments on the proposal. 40 Fed. Reg. 18187 (April 25, 1975). After considering all the comments received, the Commission, on June 24, 1975, adopted an anti-fraud rule broadly prescribing fraudulent and deceptive practices and the making of false statements in connection with commodity option transactions. 17 C.F.R. Section 30.01 (1976), 40 Fed. Reg. 26504 (June 24, 1975). In the release announcing the adoption of this anti-fraud rule, the Commission emphasized that, since the Commission had been granted exclusive jurisdiction with respect to option transactions, there existed a regulatory gap which was necessary to close as quickly as possible.

Thereafter, on October 22, 1975, the Commission announced that it was considering the adoption of rules to regulate transactions in commodity options, and had assigned to its Advisory Committee on the Definition and Regulation of Market Instruments ("the Advisory Committee") the responsibility to study and make appropriate recommendations to the Commission on the subject of commodity options. 40 Fed. Reg. 49360 (October 22, 1975). The Commission requested written public comments concerning what, if any, temporary rules might be promulgated. For this purpose, comments were solicited both as to option trading in general and on the merits of several specific regulatory alternatives.

The Commission on February 20, 1976, proposed the adoption of comprehensive regulations governing off-exchange commodity option transactions. 41 Fed. Reg. 7774 (February 20, 1976).

The Commission announced that it would hold an oral hearing on March 8 and 9, 1976, to permit the further presentations on the matter. At the oral hearing on March 8, various witnesses appeared and presented their views on the proposed regulations.

On July 6, 1976, the Advisory Committee transmitted its report on commodity option trading to the Commission. After over seven (7) months of analysis of these various forms of option trading, the Advisory Committee recommended that, with limited exceptions, no form of option trading should be prohibited, provided that a showing could be made, with respect to each category of option trading, that certain basic customer protections could be provided to option customers.

After consideration of the public comments received on its prior proposals, the presentations made at its oral hearing on March 8, 1976, and the report and recommendations of its Advisory Committee, the Commission published proposed interim option regulations on October 8, 1976. 41 Fed. Reg. 44560, 44566-68 (October 8, 1976). These proposed interim regulations were announced by the Commission as the first stage of a two-step procedure to adopt comprehensive regulations for a limited, rigidly-controlled, three-year pilot program that would ultimately restrict commodity option transactions to domestic boards of trade and foreign commodities exchange systems which satisfied stringent regulatory requirements. 41 Fed. Reg. 44560 (October 8, 1976). Through that test program, the Commission expected to obtain sufficient data involving the impact of commodity options trading on underlying futures and cash markets, the economic utility of such options trading, and the capabilities of exchanges to conduct adequate market surveillance and assure orderly markets in options, upon which to base a permanent regulatory program for commodity option transactions, or, if necessary, to determine to ban options trading altogether.

Id.

The Commission stated that the interim regulations were designed to provide minimal customer protections in the offer and sale of commodity options which, until the second stage of the regulations could be implemented, would be allowed to continue to be conducted otherwise than through the facilities of organized

exchange systems. The Commission explained that the registration, financial, segregation, and disclosure requirements contained in the proposals had been designed to effectuate the customer protection objective and to permit a gradual phase-in of the test program restricting option trading to designated domestic contract markets and Commission-recognized foreign commodities exchange systems. The Commission expressed its intention to adopt and make effective the proposed interim regulations on November 22, 1976. 41 Fed. Reg. 44560 (October 3, 1976). Interested persons were invited to submit written comments on the proposed rules to the Commission prior to November 8, 1976. Id. at 44568.

The Commission adopted the interim regulations substantially in the form previously proposed. 41 Fed. Reg. 51808 (November 24, 1976). In view of certain revisions the Commission deemed necessary, the effective dates of certain provisions were deferred for fifteen (15) days, except in the case of the segregation requirements which were deferred for thirty (30) days. Id.

As adopted, the regulations generally (1) make it unlawful on and after January 17, 1977, for any person to accept money or property from an option customer as payment of the purchase price of a commodity option unless such person is registered with the Commission as a Futures Commission Merchant (Section 32.3, id. at 51815); (2) require individuals soliciting or accepting orders for commodity option transactions or supervising any person so engaged to register with the Commission as an associated person of a specified futures commission merchant by January 17, 1977 (Section 32.3, id. at 51814); (3) provide that registered Futures Commission Merchants engaged in commodity option transactions maintain a minimum adjusted working capital of Fifty Thousand Dollars (\$50,000.00) or an amount computed on the basis of a percentage of aggregate indebtedness and a percentage of unrealized values of futures contracts with respect to both proprietary and customers' accounts (Section 1.17, id.);

and (4) require persons engaged in the offer and sale of commodity options to segregate in a separate account in the United States the money or property accepted from an option customer as payment of the purchase price of a commodity option, except to the extent of ten percent (10%) of the purchase price, until expiration of the term of the option or, if the option is exercised, until all rights of the option customer under the option have been fulfilled (Section 32.6, id. at 51815-51816). The regulations also require that persons engaged in the offer and sale of commodity options provide prospective option customers with a summary disclosure statement setting forth general information relating to the option being offered, including a listing of the elements comprising the purchase price to be charged and a general description of all other costs incurred, and that any person, as part of the written confirmation of the execution of a transaction, furnish the option customer with particularized price information regarding the option within twenty-four (24) hours after execution. Section 32.5, 41 Fed. Reg. 51808, 51815 (November 24, 1976). Furthermore, Section 32.7 of the regulations requires each person engaged in the offer and sale of commodity options to maintain pertinent books and records, as therein specified, relating to the solicitation and the accounts of option customers. Id. at 51816.

In the Federal Register notice publishing the regulations, the Commission determined that, with the exception of Section 32.6 relating to the segregation of premiums, all other provisions of the regulations would become effective fifteen (15) days after publication -- i.e., on December 9, 1976. The Commission stated that the public interest required that the rules be adopted without any further delay.

SUMMARY OF ARGUMENT

I.

In order to grant a Motion for Summary Judgment, the court under Rule 56(c) of the Federal Rules of Civil Procedure must determine that (1) there is no genuine issue of material fact involved and (2) the moving party is entitled to a judgment as a matter of law. The regulations in question were published on November 24, 1976 in 41 Fed. Reg. 51808, the major portion of which was to become effective fifteen (15) days thereafter. This is in violation of 5 U.S.C. 553(d) (1967) which requires that a regulation be published thirty (30) days before its effective date unless, inter alia, the agency demonstrates good cause for the earlier date. The Commodity Futures Trading Commission's (CFTC) only proof of good cause was merely that they wanted the regulations to become effective since the public had been without their "protection" since the enactment of the Commodity Futures Trading Commission Act of 1974. This showing is insufficient under 5 U.S.C. 553(b)(3).

The regulations were also promulgated in violation of Section 4c(b) of the Commodity Exchange Act (Act) 7 U.S.C. Section 6c(b)(Supp. V. 1975) as amended by the Commodity Futures Trading Commission Act of 1974. These provisions were added in 1974 to give the Commission jurisdiction over option transactions but also required that before a rule or regulation was issued, notice and an opportunity for a hearing had to be provided. This specific provision was an addition to the already existing authority of the Commission or its predecessors under Section 8a(5) of the Act, 7 U.S.C. 12a(5) (Supp. V., 1975) to promulgate such rules and regulations as deemed necessary. Under the latter general provision which existed prior to 1974, the Commission is required under 5 U.S.C. 553(c) (1967) to provide opportunity for notice and comment. Congress, by amending Section 4c(b) of the Act, specifically required that rules promulgated in the new area of option transactions be made only after an opportunity for hearing by interested parties. Failure to abide by this explicit

Congressional mandate invalidates the rules. For this reason, the Commission was not entitled to summary judgment on the issue of the procedural validity of the rules as a matter of law under Rule 56(c).

II.

The District Court also erred in granting summary judgment on the substantive validity of regulations 1.17, 32.3, 32.5 and 32.7 since NASCOD raised genuine questions of material fact concerning whether the Commission acted arbitrarily in promulgating them. The "fundamental maxim" of summary judgment as enunciated by this Court in Heyman v. Commerce and Industry Insurance Company, 524 F.2d 1317 (2nd Cir. 1975) is that a court cannot resolve issues of fact on a motion for summary judgment. In addition, the Court noted that all reasonable inferences must be resolved in favor of the party whom the motion is lodged against. The burden as declared by the Supreme Court in Adickes v. S. H. Kress & Company, 398 U.S. 144 (1970) is upon the moving party and if the moving party does not sustain its burden of proving the absence of a material fact, then summary judgment should be denied, even if no opposing evidentiary material is presented.

In the present case, genuine material questions of fact were raised concerning whether the Commission acted arbitrarily and capriciously within 5 U.S.C. 706(2)(A)(1967) by promulgating rules which were unreasonable and in violation of section 15 of the Act, 7 U.S.C. Section 19 (Supp. V. 1975) which requires that the Commission "endeavor to take the least anti-competitive means of achieving the objectives of this Act." The Commission's stated purpose of the rules is to ensure "minimal container protection" and as more fully discussed herein, the regulations in part do not ensure any greater degree of protection than less anti-competitive regulations would and in part so far exceeds the "minimal" protection sought, that the regulations are unjust in light of section 15 of the Act. Since many genuine material

questions of fact were raised, the District Court should not have granted summary judgment under the clear wording of Rule 56(c) of the Federal Rules of Civil Procedure.

I. THE DISTRICT COURT ERRED IN GRANTING THE APPELLEES A SUMMARY JUDGMENT AS TO THE PROCEDURAL VALIDITY OF THE REGULATIONS BECAUSE A GENUINE DISPUTE EXISTED AS TO A MATERIAL FACT, TO WIT: THE EXISTENCE OF GOOD CAUSE WITHIN 5 U.S.C. 553(d)(3).

A. The Standards By Which A Summary Judgment May Be Granted Are Governed by Rule 56 of the Federal Rules Of Civil Procedure. In Order For Summary Judgment To Be Rendered, There Must Be

(1) No Genuine Issue As To Any Material Fact, and

(2) A Showing That The Moving Party Is Entitled To a Judgment As A Matter Of Law. Rule 56 F.R.C.P.

It is clear that on a Motion for Summary Judgment it is improper for the Court to try issues of fact. This Court has stated in U. S. V. Bosurgi, 530 F.2d 1105 (2d Cir., 1976), that summary judgment is a drastic measure and should only be used when the requirements of Rule 56 are clearly met. Furthermore, a court, in passing on a motion for summary judgment must resolve all ambiguities in favor of the party against whom the motion is made. Id at 1110. Even if a party's case is weak, it should not be deprived of a trial if it has produced enough evidence to show that there is a genuine issue of fact. Courts cannot enter judgment as a matter of law in a manner similar to a directed verdict under Rule 50(A) of the Federal Rules of Civil Procedure where there is a fact in issue. Hughes v. American Jawa, Ltd. 529 F.2d 21 (8th Cir. 1976.) In Hughes the Court went so far as to say that even if a Court is sure that it will issue a directed verdict, it should hear the evidence and direct a verdict later rather than try the case in advance on a motion for summary judgment. Id at 25. The evidence only need have "legally probative force" to create a genuine issue of fact.

Recently this Court in Heyman v. Commerce and Industry Insurance Company 524 F.2d 1317 (2nd Cir.) 1975, fully discussed the nature of a summary judgment. The Court noted that although summary judgment is being granted more often in recent cases, the fundamental maxim remains that a court cannot resolve issues of fact on a motion for summary judgment. Id at 139. The Court noted that the remedy is a drastic device and all reasonable inferences should be in favor of the party against whom the motion is made. The burden is on the moving party to show the absence of a material fact and if the moving party fails to sustain his burden, then summary judgment should be denied even if no opposing evidentiary matter is presented. Adickes v. S. H. Kress and Company 398 U.S. 144, 157 (1970).

B. The Appellees, Commodity Futures
Trading Commission (C.F.T.C.) Clearly
Failed to Sustain Their Burden Of
Proving The Absence Of A Genuine
Question Of Fact Concerning The
"Good Cause" Requirement Within
5 U.S.C. 553(d)(3).

The C.F.T.C. in its Memorandum in Support of Motion for Summary Judgment at page 57 merely cites the statement in 41 Fed. Reg. 51817 wherein the Commission made its statement for implementing the regulations prior to the thirty (30) day period as required in 553(d). The statement merely contains general conclusions that the public interest requires that the rules be adopted prior to the thirty (30) day required period without a showing of any reasons or facts upon which it relies. The Commission further tried to justify its violation of Section 553(d) by stating that all affected persons had adequate notice and opportunity to comment on the regulations. The fact that affected persons did or did not participate is irrelevant to the issue of whether good cause was established as required in Section 553(d). The Commission under Section 553(c) is required by law to give "interested persons an opportunity to participate in the rule making through submission of written data, views

or arguments. . ." The fact that all persons had ample notice to comment on the regulations in compliance with Section 553(c) cannot be a basis for finding good cause under Section 553(d). If so, then all regulations which the public has commented upon could be implemented immediately upon publication in the Federal Register which would obviously be a violation of Section 553(d), unless good cause was shown. In Kelly v. U.S. Department of the Interior, 339 F.Supp. 1095 (E.D. Calif., 1972) the plaintiffs sought to enjoin enforcement of regulations which had become effective upon publication in the Federal Register. The agency offered as its reason the fact that a year had passed from the time the statute was amended to the date the regulations were published and the agency did not want the public to go without the benefits of the regulations any longer. The Court rejected this reason, holding that the agency had not shown why thirty (30) more days would make a difference. The Court, after finding that the agency had not established good cause, held that the regulations were invalid, citing Hotch v. U. S., 212 F.2d 280 (9th Cir., 1954) wherein the Court stated "if notice of a proposed rule is not published in the Federal Register at least thirty (30) days prior to its issuance, or if good cause is not found and published for the immediate issuance of a rule, the rule cannot be legally issued; if the rule itself is not published, it follows that it has not been issued; and if a rule has not been issued, it has no force as law." Id at page 284. The C.F.T.C.'s sole basis for showing good cause is its decision that the public needs these regulations for their protection. This showing is no more sufficient than what was held insufficient in Kelly v. Department of Interior, supra.

C. The District Court
Made A Factual Determination
Below Which Is Improper In
Ruling On A Motion For
Summary Judgment.

The very nature of proving good cause itself precludes summary judgment. The determination of the existence or absence of good cause requires the

weighing of several factors derived from conflicting facts. The lower court did not find the absence of a material fact but rather made a finding of fact, improper under Rule 56. The Court, on page 17 of its opinion, states ". . .we find the Commission adequately stated and published good cause for its actions." Therefore, it is clear that a factual question exists as to whether the C.F.T.C. made a proper showing of good cause, and the lower court's grant of Summary Judgment was improper under Rule 56.

II. THE DISTRICT COURT ERRED IN GRANTING
THE APPELLEES' SUMMARY JUDGMENT AS A
MATTER OF LAW BECAUSE THE REGULATIONS
WERE PROMULGATED IN VIOLATION OF
CONGRESSIONAL MANDATE FOR NOTICE AND
OPPORTUNITY FOR A HEARING.

A. The Appellants Were Denied
Adequate Participation In All
Phases Of The Rule Making
Proceeding And Especially
During The Period Between
October 8, The Date Of
Publication Of The Proposed
Rules And November 24, The
Publication Of The Adopted Rules.

The Administrative Procedure Act, 5 U.S.C. 553(c) requires certain procedures for informal rule making. Congress may, however, prescribe additional procedures to those required in Section 553, see Section 559. Congress, in the Commodity Futures Trading Commission Act of 1974 (CFTC Act), Title 4, Section 402(c) amended Section 4c(b) of the Commodity Exchange Act, 1936 (Act) 7 U.S.C., Section 6c(b) (Supp V 1975) to give the newly created C.F.T.C. authority to regulate option transactions but included the condition, "Provided that any such order, rule or regulation may be made only after notice and opportunity for a hearing." These words clearly require that some form of procedure in addition to those contained in 553(c) are required before the C.F.T.C. can promulgate rules governing option transactions.

Section 12a(5) of 7 U.S.C. was originally contained in the Commodity Exchange Act of 1936. It allowed the predecessor of the CFTC, the Secretary of Agriculture, to promulgate such rules and regulations as were reasonably necessary to effectuate the provisions of the Act. Under such a provision of a statute, the APA, at Section 553, required the Secretary, or lately the CFTC, to provide an opportunity for interested persons to submit written materials and comments.

Congress must have been aware of this provision of the APA and therefore when it specifically added to Section 4c(b) of CFTC Act the requirement for

notice and opportunity for hearing, its intention must have been to require procedures in addition to those already required under Section 553(c) of the APA. Unless so interpreted, the words requiring a hearing in Section 4c(b) of the Act were superfluous but a statute should be construed to give effect to all its provisions so that none are inoperative or superfluous. U.S. v. Blastus 397 F.2d 203 (2nd Cir. 1968) Cert. dismissed. 393 U.S. 1008 (1969); U.S. v. Dinnerstein 362 F.2d 852 (2nd Cir. 1966).

The Appellants recognize that under U.S. v. Florida East Coast, 410 U.S. 224 (1973), the words in 7 U.S.C. Section 6c(b) (Supp V, 1975) referred to above are insufficient to call into play the formal rule making provisions of Section 556 and Section 557 of the APA. However, as the Court of Appeals held in Mobil Oil Corporation v. F.P.C., 483 F.2d 1238 (D.C. Cir., 1973), a statute may require some form of hybrid procedures, that is, more than what is called for in Section 553 (c), but not all those procedures required under Section 556 and Section 557 of the APA. It is clear that Congress intended some form of hybrid procedure in this situation since the C.F.T.C. itself was newly created by the Act and given an area to regulate never before regulated by this or any other agency, namely commodity options. The C.F.T.C. was not in a position to rely upon any accumulated "agency expertise" in this area since none existed in the new agency and for this reason it is safe to assume that Congress wanted to be sure that a maximum amount of evidence was presented upon which the C.F.T.C. could promulgate its rules.

The C.F.T.C. in its memorandum referred to herein, relies upon U.S. v. Florida East Coast, supra. for the proposition that it was not required to provide any more procedures than those contained in Section 553(c) of the APA. In U.S. v. Florida East Coast, supra., the Court stated, ". . . it cannot be doubted that a statute that requires a 'hearing' prior to rule making may in some circumstances be satisfied by procedures that meet only the standards of Section 553." (Emphasis added). Id at

241. This strongly suggests that there are also circumstances when a statute requiring a hearing may demand more than what Section 553(c) calls for. U.S. v. Florida East Coast, supra. can also be distinguished from the present case in that the statute in question in U.S. v. Florida East Coast, supra. did not contain a general rule making provision and a more specific one requiring a hearing before rules could be promulgated in that specific area.

From the above it is amply clear that Congress in passing the CFTC Act wanted to invest the C.F.T.C. with regulatory powers over all option transactions and conditioned the agency's power to promulgate rules in this area, upon notice and opportunity for a hearing. Since the agency failed to comply with this statutory requirement, the rules published in 41 Fed. Reg. 51808 are invalid and the lower courts' grant of Summary Judgment was error.

III. THE DISTRICT COURT ERRED BY GRANTING THE APPELLEE'S
MOTION FOR SUMMARY JUDGMENT AS TO THE SUBSTANTIVE VALIDITY
OF THE REGULATIONS SINCE GENUINE QUESTIONS OF MATERIAL FACT
EXIST AS TO EACH REGULATION IN QUESTION

A. Factual Questions Exist As To
The Reasonableness Of 7 C.F.R. 1.17 (Adjusted
Working Capital) As Amended
In 41 Fed. Reg. 51814 (Nov. 24, 1976) Which Precludes
A Granting Of Summary Judgment On The
Issue.

The Commission failed to sustain its burden of proving the absence of material factual questions concerning the reasonableness of the minimal financial requirements in 7 C.F.R. 1.17 as amended in 41 Fed. Reg. 51814 and therefore its motion for summary judgment should not have been granted. NASCOD does not challenge the concept of establishing a minimal financial requirements but do challenge as unreasonable and arbitrary within the meaning of 5 U.S.C. 706 (2)(A) (1967) the disparity between the minimal financial requirements established for Futures Commission Merchants dealing in futures and Futures Commission Merchants dealing in options.

The Commission explains on page 34 of their memorandum referred to herein, that Fifty Thousand Dollars (\$50,000.00) in adjusted working capital is necessary in order to protect options customers from the possible bankruptcy of the option vendor. The Commission further states that because those who deal in futures contracts mark to market daily, a financial safeguard implicitly missing in the option industry, a higher minimal financial requirement is justified.

Throughout the Commission's memorandum is the idea that the options industry is more speculative and less financially less responsible than the futures industry. Nowhere has the Commission documented this assumption. Since the stated reason for the disparity is the Commission's belief that options dealers are not financially responsible, it should offer some evidence of this belief. At a minimum,

this is a factual question upon which it was improper to grant summary judgment.

The Commission states in many parts of its memorandum referred to herein, the minimal financial requirements will insure protection to customers if the dealer becomes insolvent. As an unsecured creditor, a customer would not have a priority claim to the dealer's working capital funds held by the dealer vis a vis secured creditors without an amendment to the Bankruptcy Act. Surely a factual question exists as to the reasonableness of this regulation if its premise has no foundation in the law. While an agency may rely upon its expertise in informal rule making, it is incumbent upon the agency to adduce sufficient evidence in the record to justify a finding that the regulations are reasonable. National Tire Dealers and Retreader's Association v. Brinegar 491 F.2d 31 (D.C. Cir., 1974). Appellants have raised a factual question as to the validity of this question and should not have been denied a chance to produce further evidence to show the unreasonableness and hence arbitrary nature of this regulation.

The Commission's alternative basis for requiring a greater minimal financial requirement for option dealers is that those dealing in futures contracts mark to market daily which is an additional safeguard implicitly lacking in the option industry. See C.F.T.C. memorandum at page 34. This safeguard also exists in the options industry. See British American Commodity Options Corporation, memorandum in support of Motion for Declaratory Judgment and Preliminary Injunction, at page 7. Therefore since options vendors also mark to market daily, there is no valid basis for the disparity in minimal financial requirements.

B. A Factual Question Was Raised By
Appellants In The Lower Court As To
The Commission's Violation of 7 U.S.C.,
Section 19 (Supp. V., 1975). Said
Section Requires That The Commission
"Endeavor to take the least anti-competitive
means of achieving the objectives of this
Act. . ."

The direct result of 7 C.F.R. 1.17 as amended in 41 Fed. Reg. 51814 (Nov. 24, 1976) as well as the other regulations adopted in 41 Fed. Reg. 51808 (Nov. 24, 1976) is to make the options industry less competitive than the futures industry. It is obvious that unless the Commission had a reasonable basis for promulgating such anti-competitive regulations, it violated the clear mandate in 7 U.S.C. Section 19 (Supp V, 1975).

Under the House version of 7 U.S.C. Section 19 (Supp V, 1975), as noted in Senate Report No. 93-1131, 1974, U.S. Code Cong. and Adm. News 5848, the Commission would have only been required to consider the anti-competitive aspect of its regulations. The Committee amended the House version to include, "and endeavor to take the least anticompetitive means of achieving the objectives of this Act. . ." The Senate report notes that the Committee amendment requires, "the Commission to take the least anti-competitive means of achieving the objectives of the Commodity Exchange Act." The Commission correctly notes in their memorandum at page 27 that Section 19 was not intended to be a procedural roadblock to regulation, but a full reading of the passage shows that the Committee was concerned that Section 19 might be interpreted as to require separate proceedings. The Committee in no way implied in said passage that it interpreted Section 19 in such a way as to give the agency freedom to pursue anti-competitive measures unless it had viable reasons for its actions. 1974 U.S. Code Cong. and Adm. News at 5896.

The C.F.T.C. was admittedly given broad powers in the Act but under Section 19 it was also given broad responsibility to ensure that their regulatory zeal would not inure to a select few and to the ultimate detriment of the very people sought to be protected. Whether the agency violated Section 19 in their zeal to amend 1.17 and promulgate the other regulations considered herein, is a question of fact that was improperly decided by the lower court's grant of Summary Judgment. In Sabin v.

Butz 515 F.2d 1061 (10th Cir., 1975) the petitioner challenged an agency regulation on the grounds that the Agency failed to consider anti-trust policies in their decision. The Court of Appeals partially reversed the lower court's grant of summary judgment for the government, holding that the petitioners sufficiently raised factual questions whether the agency's actions were arbitrary for failing to consider anti-trust policies. Id at 1070. In Marrone v. the United States Immigration and Naturalization Service, 500 F.2d 418 (2nd Cir., 1974) this Court reversed a grant of summary judgment and noted that if there is any substance to the allegations, then factual issues raised by the allegations preclude summary judgment. Id at 420.

The Commission stated in 41 Fed. Reg. 44560 (October 8, 1976) which was incorporated by reference in 41 Fed. Reg. 51808 (November 24, 1976) that the interim regulations were designed to provide "minimal customer protections." Due to the extreme severity of the minimal financial requirements in I.17, and the other regulations, it is doubtful whether the minimal financial requirements as established were necessary to ensure "minimal" protection. Several proposals were rejected out of hand by the Commission which would have been less devastating upon the industry and would have provided just as extensive customer protection. In point of fact, the Commission has never shown why the extremely stringent financial requirements are necessary to insure minimal protection. Due to the many factual problems raised by appellants concerning the reasonableness of I.17, summary judgment was improper.

IV. THE DISTRICT COURT ERRED IN GRANTING
SUMMARY JUDGMENT BELOW WHEN QUESTIONS OF
MATERIAL FACTS WERE RAISED CONCERNING THE
NECESSITY OF REGULATIONS 32.3, 32.5, 32.7
AS WELL AS VIOLATIONS OF 7 U.S.C., SECTION
19. (SUPP V, 1975)

Regulation 32.5 as published in 41 Fed. Reg. 51815 (November 24, 1976) no longer requires that full disclosure be given to a customer twenty-four (24) hours prior to his entry into an options transaction, but it still requires in 32.5 (a) that disclosure be made prior to entry into the transaction. NASCOD does not challenge as unreasonable the necessity for disclosure and even disclosure prior to entry into the transaction, but rather challenges that the information required to be disclosed is often unavailable to give and the Appellants are therefore subject to the penalties provided in the regulations.

Option dealers are required to disclose information not available prior to the transaction pursuant to regulation 32.5(5). Since that requirement does not exist for Futures Commission Merchants dealing only in futures, the Commission should have documented its belief that the option market is so much more speculative that this disparity is not arbitrary. A question of fact was raised below over this very premise as evidenced by the affidavit of Peter E. Arron at page 9 wherein the affiant shows that the risk in the option market is limited in contrast to the much greater risk in the futures market. This Court said in First National Bank of Cincinnati vs. Pepper, 454 F.2d 626 (2nd Cir. 1972) when factual allegations are raised in the pleadings of a party against whom a motion for summary judgment is made, and supported in an affidavit or other evidentiary material, then those factual allegations must be taken as true. Since the factual allegations raised by appellants are to be taken as true, a serious question of fact was raised as to the necessity of the stringent disclosure requirement for option dealers when the more volatile futures market is not so regulated. Further questions concerning the reasonableness of regulation 32.5

involve a confirmation required to be given to the customer within twenty-four (24) hours after the execution of the option transaction. Reference is made to page 10 of Peter Arron's affidavit wherein he shows how in the normal course of business, this requirement would be impossible to meet. The only explanation for the unreasonable treatment given to option dealers by the Commission is the prejudice against the industry. Judge Knapp correctly recognized in his opinion at page 14 that Congress did not impose any standards to guide the Commission in Section 4c(b) of the Act, 7 U.S.C. 6c(b) (Supp. V, 1975) and such failure imposed "on the Commission the obligation of taking particular pains to ensure that its rule-making will not be arbitrary or capricious." NASCOD strongly contends that the Commission has not fulfilled this responsibility imposed upon them.

Questions of fact were raised in the lower court as to not only the necessity of such extensive disclosure but also as to the necessity of some portions of regulation 32.7 and a possible violation of section 1.19 in connection with regulation 32.5. The Commission failed to offer a persuasive reason why only option dealers were singled out to maintain such extensive records, not only covering present customers, but also prospective customers. In many cases, as noted on page 9 of the Amended Complaint of British-American Commodities Option Corporation, an option dealer has no way to verify whether the name and address given by a solicited customer is correct. The Commission takes the unbelievable position on page 46 of its memorandum that verification is not required as long as the Commission can contact the customer. One wonders how an option dealer can assure the Commission that they can contact prospective customers if they have not verified the name and address of the customer. Throughout this case, NASCOD has not urged that regulations are unnecessary, but rather has taken the position that the regulations as adopted in 41 Fed. Reg. 51808 (November 24, 1976) are unreasonable and as proposed cannot and will not achieve the Commission's stated purpose, to wit: minimal customer protections.

In Dwen v. Barry, 483 F.2d 1126 (2nd Cir. 1973) the protections. In Dwen v. Barry, 483 F.2d 1126 (2nd Cir. 1973) the petitioner challenged the reasonableness and necessity of regulations governing the length of hair permissible for a policeman. This Court reversed the lower court's dismissal under Rule 12(b) of the Federal Rules of Civil Procedure and said in dicta, that summary judgment would also have been inappropriate because factual questions were raised about the reasonableness or necessity of the regulation. Similarly, in this case sufficient factual questions were raised concerning the reasonableness of regulation 32.5 and 32.7 which should have precluded the District Court from granting summary judgment.

NASCOD finally contends that the Commission's decision on regulation 32.3(a) to require option dealers to register as Futures Commission's Merchants (FCM) was unnecessary and served no useful purpose. The immediate effect of requiring option dealers to register as FCM's is to subject them to regulation 1.19 which prohibits an FCM from guaranteeing the performance of the option. To forbid an option dealer from guaranteeing performance of an option is to contradict the whole purpose of the regulations, to wit: customer protection. A dealer who wishes to guarantee performance as an additional measure of protection should not be thwarted in his attempt by regulations whose purpose is supposedly to protect the customer. The appellants believe that Section 1.19 originally was intended to protect against the sale of "naked" or "uncovered" options. If that is the purpose, then Section 1.19 could be more clearly stated. The purpose behind Section 1.19 is a factual question which must be resolved in order to determine if the agency has acted arbitrarily and capriciously as it must not do under 5 U.S.C. Section 706(2)(A)(1967).

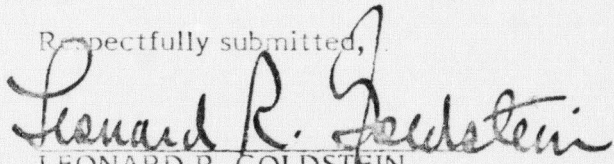
NASCOD respectfully submits that the questions raised herein would have been better resolved in a full evidentiary hearing rather than on a motion for summary judgment, and in fact, under the clear wording of Rule 56, summary judgment

was inappropriate because of the factual questions raised. It is apparent that Judge Knapp felt compelled to either grant appellant's motion for injunctive relief or grant the Commission's counter-claim for summary judgment. The Third Circuit states in Brooks v. Nacrelli, 415 F.2d 272 (3rd Cir. 1967) on remand 331 F.Supp. 1350 (E.D. Pa., 1971) aff'd 473 F.2d 955 (3rd Cir., 1973) that it is, "...well settled that successfully resisting a motion for preliminary injunction where factual issues are presented does not entitle defendant to summary judgment without opportunity to present additional evidence, if need be on final hearing". Id. at 275. From the decisional law cited herein, it is clear that appellants must have all inferences and ambiguities viewed in their favor and the factual allegations raised by NASCOD taken as true. It follows that questions raised as to the reasonableness and the necessity of each regulation created a genuine material factual question whether the Commission acted arbitrarily and capriciously within the meaning of 5 U.S.C. 706(2)(A)(1967) which should have precluded the District Court from granting summary judgment.

CONCLUSION

WHEREFORE, NASCOD respectfully urges this Court that it reverse the decision of the lower court granting summary judgment and remand the case for a full evidentiary proceeding and reverse the decision of the lower court denying preliminary injunctive relief.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that copies of the foregoing brief have been delivered to Charles J. Hecht, counsel for British American Commodity Option Corp., and Frederic T. Spindel, counsel for the Commodity Futures Trading Commission this

26th day of January, 1977.


LEONARD R. GOLDSTEIN

